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Current Polish Economic and Financial Situation

Domestic Economy: Slide Continues

- Industrial production was 10 percent lower in January-February than in the first two months of 1980. [REDACTED]

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Particularly dismaying was a 25 percent drop in production for export markets, including a 25 percent drop in coal production. The lagging mine output is largely attributable to the shorter workweek and frequent work stoppages in January. The slump in industrial output has been accompanied by an 18 percent rise in wages -- providing a double-barreled boost to inflation.

- Prospects for a rise in output remain bleak. Shortages of both domestic and imported industrial inputs, cutbacks of electrical energy, and the shortened workweek will hold this year's production below 1980 levels. Nevertheless, in line with promises made to Solidarity the regime is giving priority to the production of foodstuffs, medicines and clothing at the expense of investment goods.

- Outlook for farm production continues to be poor. Unfavorable weather last fall reduced the area sown to winter grains, while shortages of seeds, fertilizer, and spare parts for machinery seem even more acute than last year. In addition, because fodder supplies reportedly are more than 10 percent short of demand the regime expects livestock numbers to drop below the six-year low reached in January. As a result, the Polish consumer can expect no relief from shortages of meat and milk this year.

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- Recent Polish statements indicate that the food supply situation could be reaching crisis proportions, with hoarding evidently becoming widespread. A Politburo member suggested that food riots could occur if supplies do not improve. In addition, a Polish economist recommended the immediate introduction of bread rationing, arguing that such a step would (a) be necessary anyway in late 1981 or early 1982 and (b) reduce waste and impress Western creditors.
- Recognizing the seriousness of the situation, the Kania government has approved several policy measures through which the military will aid agriculture, especially during the spring planting. These include the early discharge of soldiers previously employed in agriculture, the detachment of mobile workshops to fix breakdowns of farm equipment, and the transfer of spare parts from the military to the agricultural sector.

External Financial Situation: Crisis Deepens

- Poland's chronically precarious financial situation continues to deteriorate and, indeed, has become considerably more desperate in the last three weeks. Financial obligations in the first quarter were met only by emergency commodity credit guarantees and bridge financing from Western governments and apparently by substantial Soviet loans. The emergency Western financing has been exhausted or at least is insufficient to enable Poland to continue to meet its debt services payments.

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- Last week, Polish representatives told a meeting of a five-nation "task force" -- composed of government officials from the US, the UK, West Germany, France, and Austria -- that it could not meet \$400 million in obligations due in March. The Poles also asked for \$1.3 billion in credits and/or rescheduling during the second quarter. Task force members agreed that Poland's arrearages should be included in a rescheduling package under study by Western governments.
- This week, at a meeting with Western bankers in London, Polish officials requested the banks to allow deferral for six months of principal repayments on unguaranteed loans due between March 26 and June 30. The banks agreed to recommend to banks in their home countries to agree to deferral one month at a time through end-June and then include the postponed payments in a rescheduling package. The Poles would be required to pay interest at the end of each monthly period through June 30. The Poles have made clear their intent to continue interest payments.
- The banks have little choice but to accept suspension of principal payments in order to avoid placing Poland in formal default. Such a move would leave the banks with even less chance of being repaid, and -- because default raises serious legal complications -- would restrict Poland's trade.
- In theory, default remains a possibility unless all banks consent to postpone debt service payments. Under lending agreements, a debtor country declared in default by one bank is placed in default to all other banks.

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Current US Policy Position on Rescheduling

The principal elements of the US rescheduling proposal are:

- Defacto rescheduling of 98 percent of principal and interest on Western government-guaranteed and government debt, consisting of (a) postponement of 90% of repayments for five years, with repayments then stretched out over another five years and (b) repayment of the remaining 10 percent in annual amounts of 2 percent for five years.
- The debt service payments to be rescheduled to be limited to payments falling due in a six-month period. The rescheduling would then be reviewed, and extended, at six-month intervals (the US objective is to provide an automatic termination after six months in the event of a Soviet invasion).
- Heavy Soviet participation in providing debt relief and new funds that may be necessary to allow a continued trade deficit.
- Implementation by Poland of a strong economic stabilization program to increase the probability aid will be put to good use.

The Europeans prefer a "consolidation period" of longer than six months, are generally less insistent on conditionality than we are, and want to reschedule a smaller proportion of debt service payments falling due. But they will probably be responsive to our proposals because of their eagerness to insure our participation in the rescheduling operation.

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A disturbing development at the Task Force meeting at the end of March was a Polish projection of a Polish trade surplus with other Communist countries in 1983 and 1984. Such a surplus -- implying Polish debt repayment to the Communist world when Western creditors are allowing Poland to suspend repayments -- is unacceptable to the US. The issue will be raised with the Poles at a meeting of government officials representing 15 Western creditor nations in Paris April 9 - 10.

Recent Western Aid to Poland

During the Jagielski visit, the US announced that it would sell Poland, for zloties, 30,000 tons dried milk and 20,000 tons of butter. The world market value of these shipments is about \$76 million.

Earlier this week, the EC announced that it would make available an additional \$230 million in food from its surplus stocks.

Earlier reports of new assistance from France and West Germany turned out to be incorrect; the aid referred to arrangements previously concluded.